

Economic & Revenue Outlook

Presented to
Senior Management, Department of Health

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Chief Economist

July 27, 2010
Olympia, Washington



WASHINGTON STATE
ECONOMIC AND REVENUE FORECAST COUNCIL



Summary

- There is evidence that the economic recovery stumbled in May – we are now predicting near-term weakness, but a continuing recovery
- The downside risk to the forecast have increased, however
 - Weak employment reports in May and June
 - Weak retail sales report in May and June
 - Fears of European contagion
- Other risks are the same as before
 - Downside: weak construction; community banks; tight credit for small business
 - Upside: exports; aerospace; software

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At this stage in 1981-82, the state economy had made up all of the job losses

Peak to trough job losses

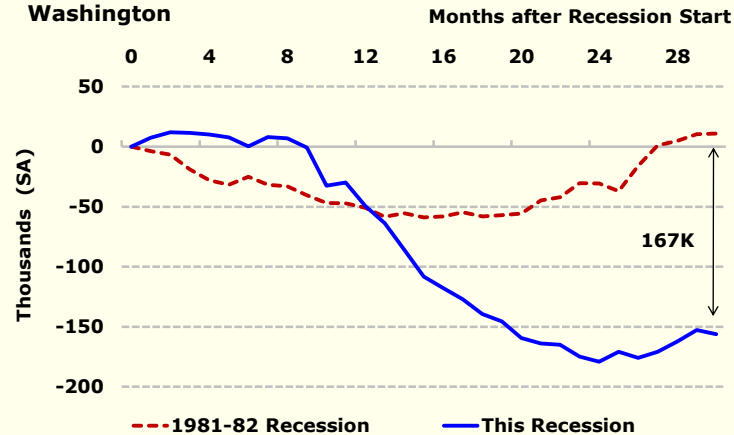
1981-82:
2.9% of labor force

This time:
5.1% of labor force

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Washington



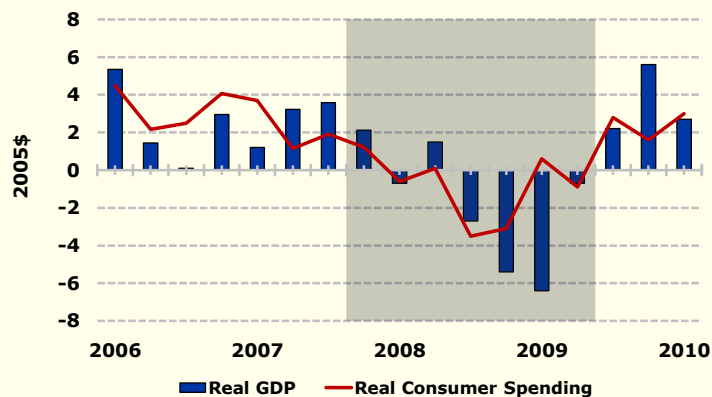
Source: WA State ESD, ERFC; data through June 2010

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We have had 3 consecutive quarters of GDP and consumer spending growth

Percent growth, SAAR



Source: BEA, data through 2010 Q1

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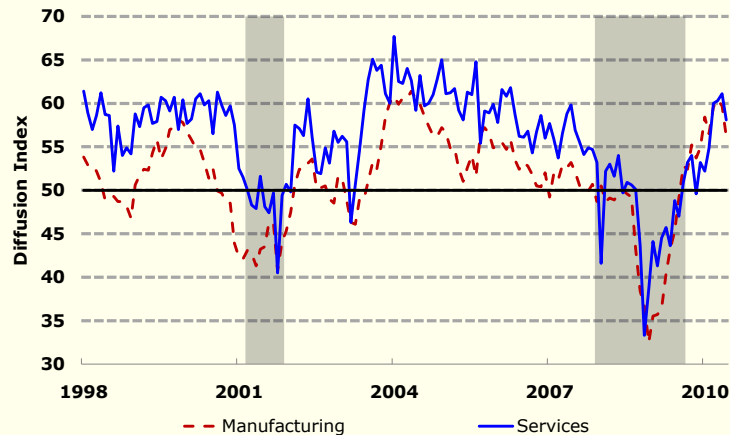


ISM indices for both services and manufacturing indicate growth

An index greater than 50, implies growth

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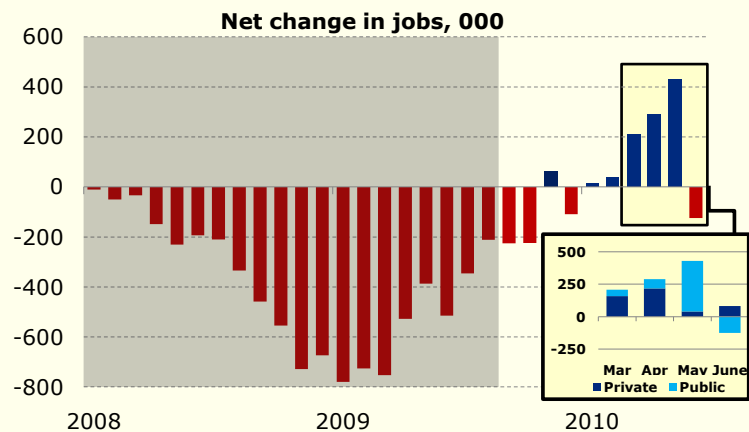


The jobs recovery stalled in May, and remains weak in June

Only 33,000 private sector jobs were added in May, down from 218,000 in April

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Fears of European contagion appear to be subsiding

This index is a proxy for fear and uncertainty in markets

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VOLATILITY S&P 500



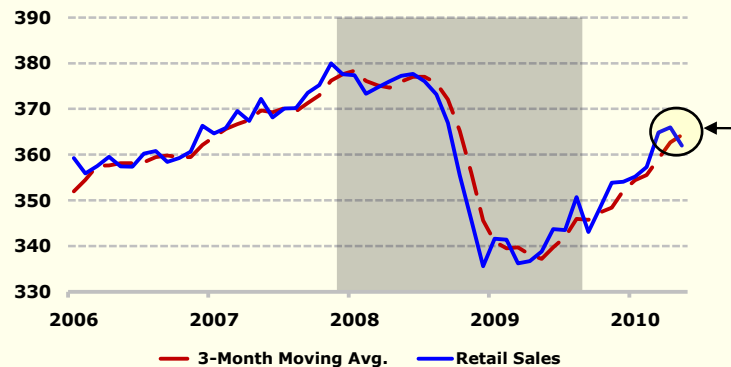
Source: Yahoo Finance; data through July 19, 2010

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Retail sales fell in May and June

U.S. Retail Sales and Food Services
USD, billions



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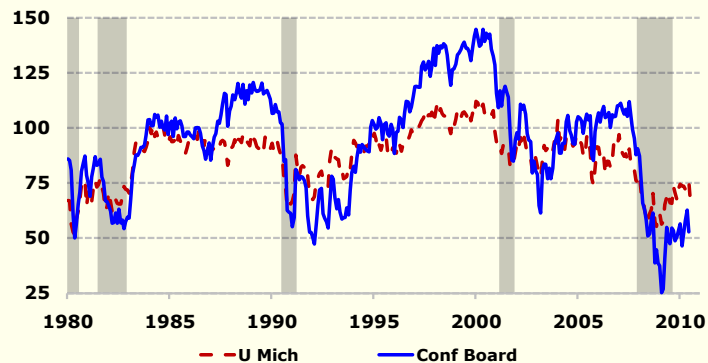
Source: U.S. Census Bureau; data through June 2010

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Consumer confidence is improving, but slowly

Index
Mich: 1966Q1 = 100, SA
Conf Board: 1985 = 100, SA



Source: University of Michigan; Conference Board, data through July 2010

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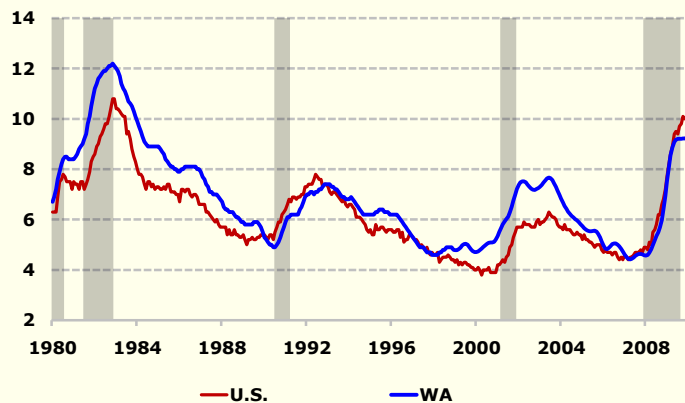
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Unemployment is still high

It is normal
for this rate
to continue
to rise even
after the
economy is
in recovery

Unemployment Rate, Percent, SA



Source: WA ESD, BLS; data through June 2010

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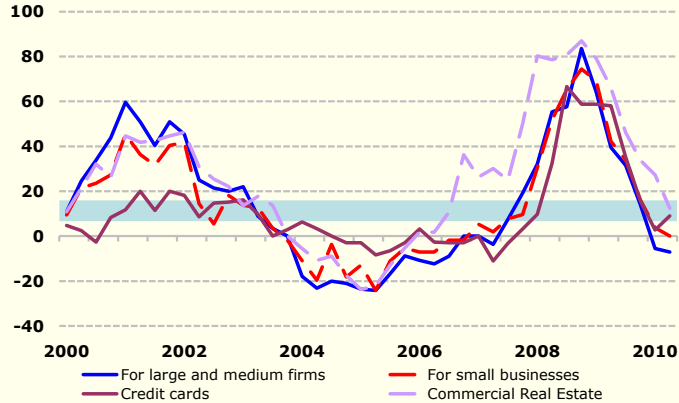
Large bank lending appears to be easing

Survey includes 60 large domestic banks and 24 U.S. branches of foreign banks

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**Net Tightening minus Easing
Percent**



Source: Federal Reserve Board, Senior Loan Officers Quarterly Survey; data through April 2010 survey

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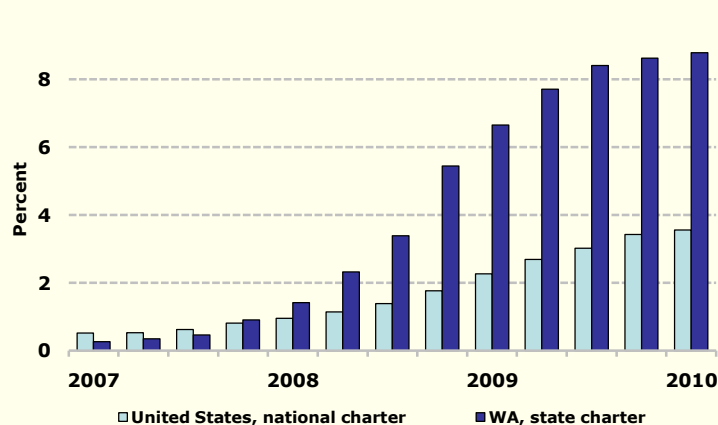
Asset quality of regional banks is poorer, but leveling off

The poorer asset quality of regional banks is due to their disproportionately high exposure to commercial real estate

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Ratio of Non-Performing to Total Assets



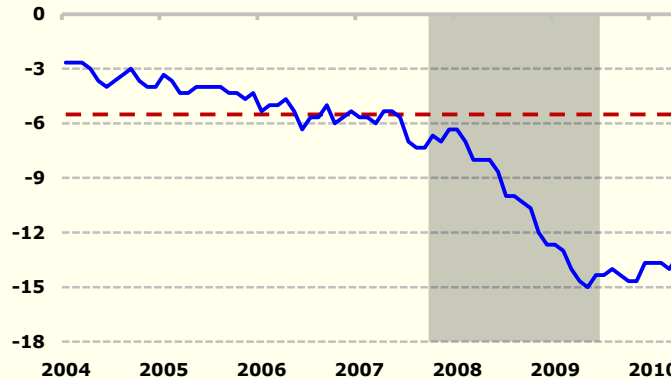
Source: FDIC, data through 2010 Q1

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Credit conditions remain tight for small business

Availability of Loans
Net Percent ("Easier" minus "Harder"), 3mma



Source: National Federation of Independent Business; data through June 2010

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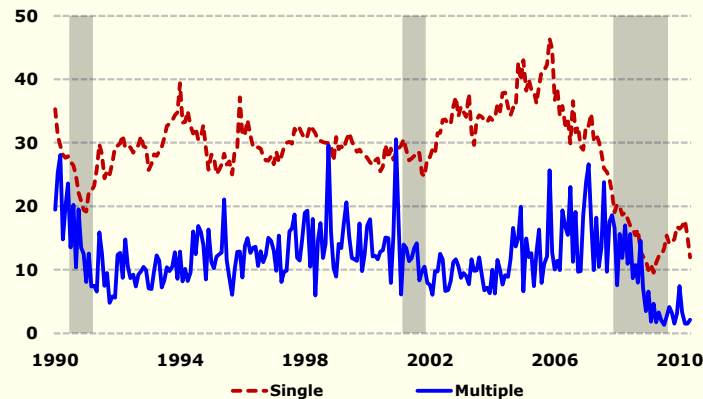
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WA single family housing has collapsed, now that the first time homebuyer tax credit has expired

Thousands, SA



Source: U.S. Census Bureau; data through May 2010

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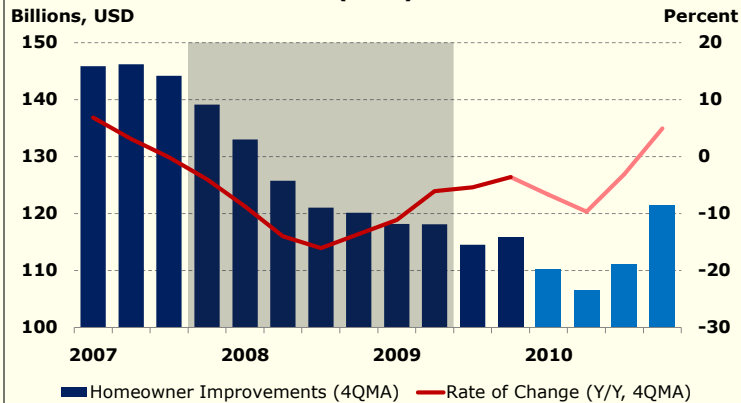
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Leading indicator suggests remodeling improvement in 2010

The Leading Indicator of Remodeling Activity (LIRA)



Source: Joint Center for Housing Studies of Harvard University, actual data through 2009 Q4

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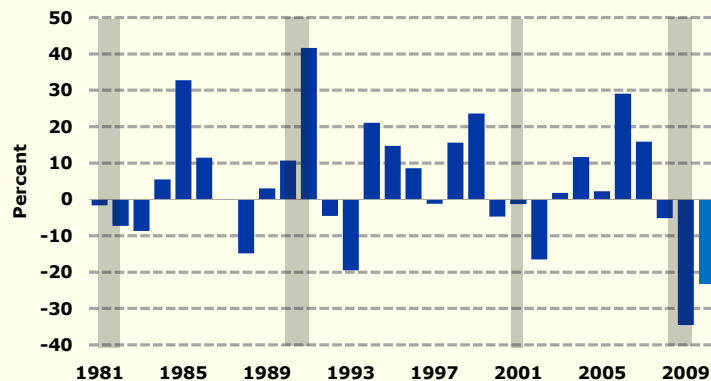
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This is the worst downturn in non-residential construction in 30 years

**Non-Residential Contract Value
Annual Percent Change**



Source: McGraw-Hill Construction, data through June, 2010

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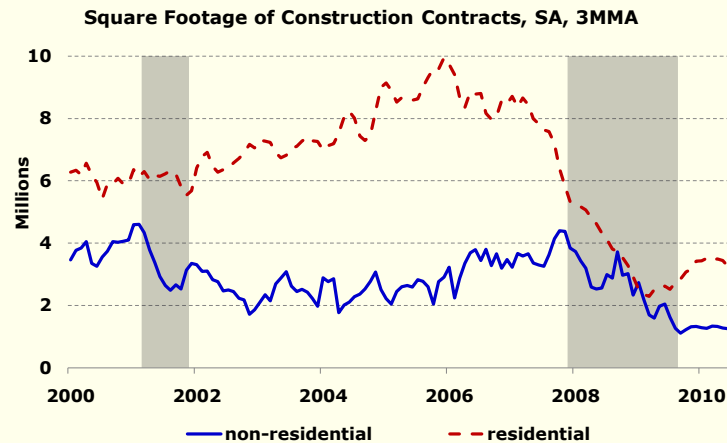


New construction in WA is no longer in free-fall, but the recovery will be weak

Residential square feet is up 55% since reaching a trough in Jan 2009

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Source: McGraw Hill Construction, ERFC; data through June 2010

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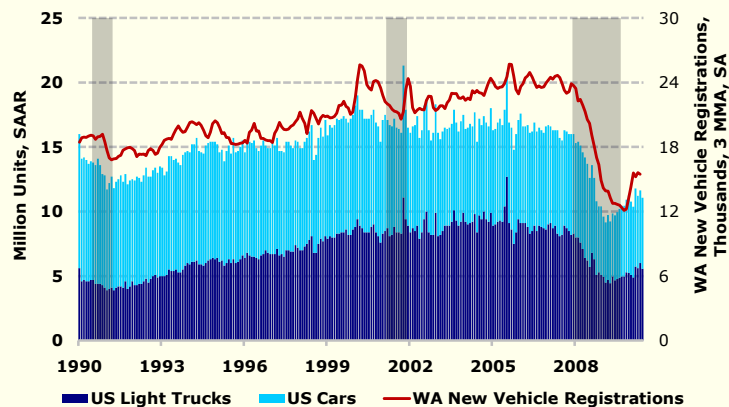
Automotive sales continue to improve

National car sales were 19% higher in May 2010 than in May 2009

Cash for Clunkers effect removed

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Source: Autodata Corporation, WA DOL; data through June 2010

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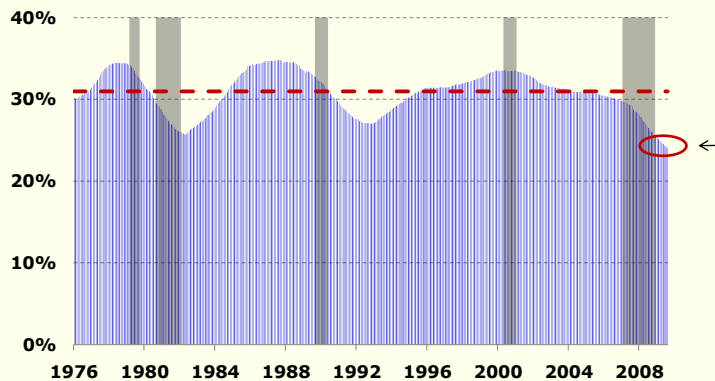
Relative age of the car fleet indicates continued turnaround in car sales

The percent of "old" cars on the road is at a historic high

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U.S. LMV Sales: Ratio of 36/120 Months



Source: Autodata Corporation, ERFC; data through June 2010

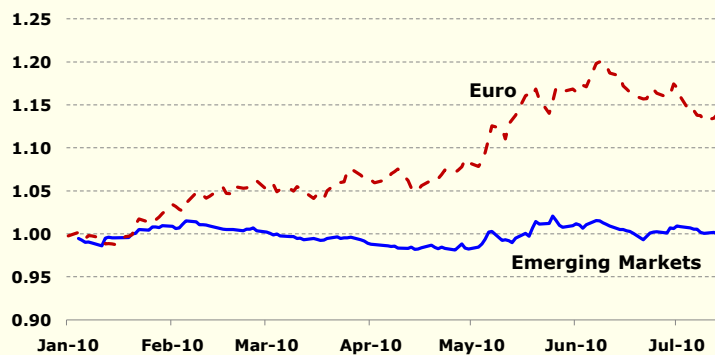
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The USD has appreciated against the EUR this year, but not against emerging market currencies

U.S. Dollar versus select currencies

Index, Dec. 31, 2009 = 1.00



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Source: US Federal Reserve Bank, ERFC; data through July 16, 2010

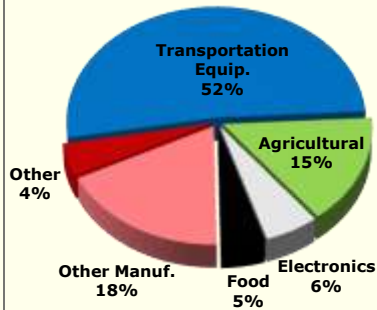
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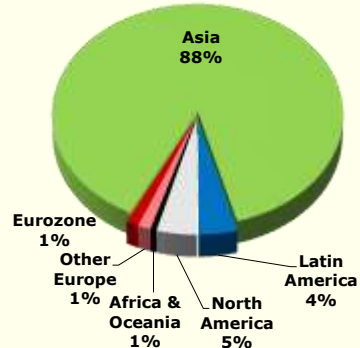
Washington exports much more to Asia than Europe

2009

By Industry



Agriculture



Source: Wiser Trade Data

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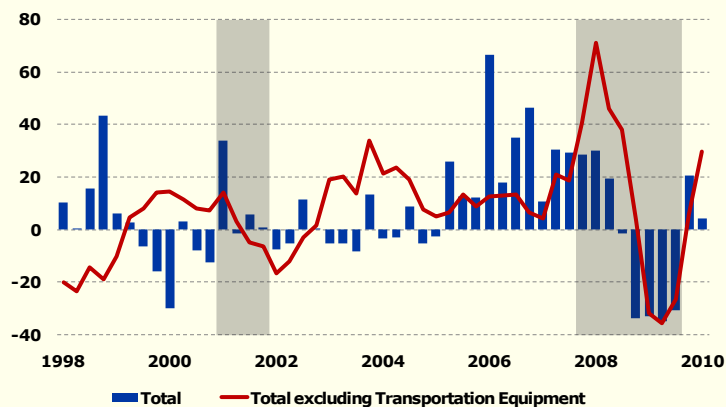
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Exports will help the state recover faster than the nation

Exports
excluding
transport
equipment
were up 30%
in Q1

Exports
Percent Change, year ago



Source: Wiser Trade Data; through 2010 Q1

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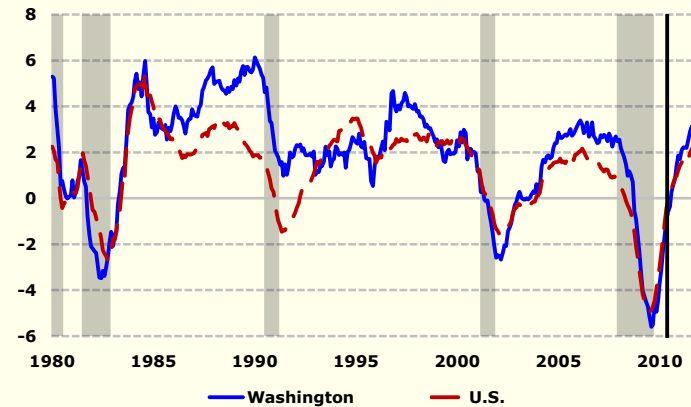
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WA employment lagged the nation in the downturn and will recover stronger than the nation

Percent change, year ago



Source: ERFC June 2010 forecast; actual through June 2010

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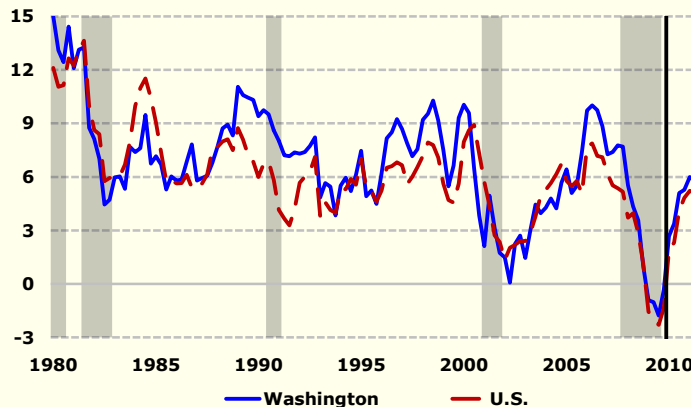
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The recovery in WA personal income growth is expected to be better than the nation's

Percent change, year ago



Source: ERFC June 2010 forecast; actual data through 2010Q1

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Forecast changes: General Fund State, 2009-2011 Biennium

**February
Forecast:**
**\$28,725
million**

**USD
millions**

	<u>Collection Experience</u>	<u>Non- economic Change</u>	June '10 Forecast		<u>Total Change*</u>
			<u>Forecast Change</u>	<u>Forecast</u>	
Dept. of Revenue	(\$34)	\$749	(\$159)	\$27,802	\$556
All other agencies	(\$5)	\$54	(\$47)	\$1,481	\$1
Total GF-S	(\$39)	\$803	(\$207)	\$29,282	\$558

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* Detail may not add to total due to rounding

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Forecast changes: General Fund State, 2011-2013 Biennium

USD Millions

**USD
millions**

	<u>February 2010 Forecast</u>	<u>Non- economic Change</u>	June '10 Forecast		<u>Total Change*</u>
			<u>Forecast Change</u>	<u>Forecast</u>	
Dept. of Revenue	\$30,658	\$1,556	\$219	\$32,433	\$1,774
All other agencies	\$1,566	\$105	(\$21)	\$1,650	\$84
Total GF-S	\$32,225	\$1,661	\$197	\$34,083	\$1,858

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* Detail may not add to total due to rounding

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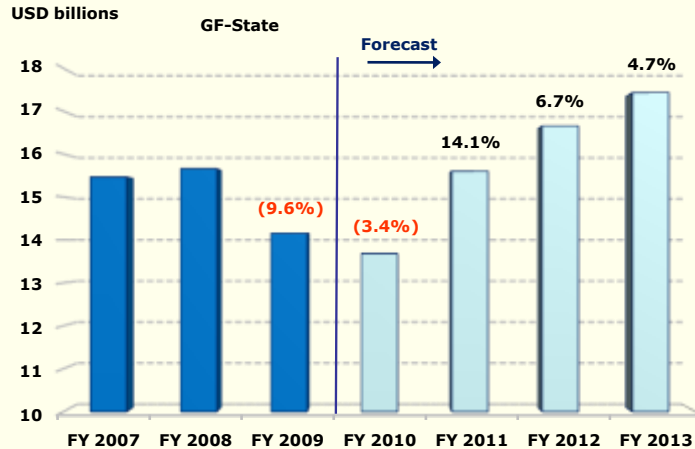
General Fund* forecast by fiscal year

* General Fund & Related Funds for FY 07, 08, and 09

General Fund – new definition, for FY 10-13

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Conclusion

Pluses

- Recovery in progress
- Evidence of pent up demand
- Job growth has returned
- Car sales are improving
- Large banks able to extend credit

Minuses

- Weak May, neutral June
- Weak consumer confidence
- Credit still tight for small business
- Slow recovery in construction
- Possibility of European contagion

- Excluding non-economic factors the forecast shifts \$200 million from this biennium to the next

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